Franklin Intermediate High Yield Municipal SMA

Franklin Separately Managed Accounts

Municipals
March 31, 2025

Product Commentary

Performance Review

- The municipal (muni) bond market, as measured by the Bloomberg Municipal Bond Index, posted a slightly negative result for the first quarter of 2025 (Q1). January and February saw positive returns supported by healthy inflows of funds and steady demand, while returns posted in March reversed those gains. Data for US fourth-quarter 2024 gross domestic product showed an annualized increase of 2.4% for the quarter, a deceleration from the third quarter's 3.1% expansion. Growth was driven primarily by consumer and government spending increases, while investments declined. Against this backdrop, the benchmark 10-year US Treasury (UST) note's yield ended Q1 36 basis points (bps) lower, at 4.21%.
- The intermediate high-yield muni strategy's performance fared better than that of its benchmark, the Bloomberg Municipal Bond Index, for the quarter.
- Our overweight to bonds that do not have external credit ratings contributed to relative returns as these issues generally outperformed other rated bonds during the quarter.
- Sector exposure was also a driver of relative results. We focus on revenue-related bonds, including pre-paid gas structured bonds and muni bond real estate issues from land development and housing projects, which continued to outperform during the quarter.
- Duration positioning was the main detractor from performance. Our underweight to bonds on the longer end of the muni yield curve curbed returns in a falling interest-rate environment.

Outlook & Strategy

- There was a significant swing in market sentiment across Q1 as participants digested the first few months of US President Donald Trump's new administration. January saw positive excess returns across a number of sectors as market sentiment moved higher in anticipation of new business friendly initiatives. This was replaced by a negative shift in risk appetite during February and March as unclear tariff policies became the market's focus. Throughout the quarter, investment-grade munis underperformed USTs. Despite modest outflows in March, muni funds overall benefited from steady inflows earlier in the quarter.
- Muni credit fundamentals remain broadly stable, with signs of improvement even in sectors that struggled post-pandemic, though revenue growth is moderating, and economic tailwinds are slowing. High reserves and fiscal flexibility continue to support most issuers, and credit ratings are expected to remain steady over the next six months, though sector-specific challenges persist.
- Potential policy changes under the Trump administration, such as the possible elimination of tax exemptions for certain bonds and the cancellation of federal leases, are adding uncertainty to the muni market outlook, alongside broader concerns about how federal decisions may impact local economies. At the same time, US consumer sentiment is softening, and overall uncertainty around the economic growth outlook has increased in response to the administration's proposed reforms and policy direction.
- However, hard data continues to indicate a resilient US economy. The labor market appears to have reached an equilibrium of a low level of both new additions and layoffs, with a still-low unemployment rate, and economic activity remains solid.
- Going forward, our economists are looking to deregulation and tax reforms to support growth over the medium term. The heightened uncertainty surrounding the administration's trade policy and the impact on US businesses makes US Federal Reserve policy difficult to predict. It remains to be seen whether risks are skewed toward a significant slowdown in growth or higher inflation. However, our economists remain optimistic on US growth, considering that the economy remains on solid footing and pro-growth measures are still expected. Consequently, we are penciling in only one 25-bp rate reduction in 2025, though an absence of rate cuts this year is also possible.

Product Details[1]

Inception Date	11/30/2022
Benchmark	Bloomberg Municipal Bond Index

1. A composite is an aggregation of one or more portfolios into a single group that represents a particular investment objective or strategy. The composite return is the asset-weighted average of the performance results of all the fully discretionary portfolios in the composite. The composite return information provided herein includes the returns of Franklin Templeton, high-net-worth individual and institutional client portfolios and with respect to any periods prior to the inception of Franklin Templeton, reflects the performance of any such other portfolios.

Performance Data

Average Annual Total Returns (USD %)

	3 Mths	YTD	1 Year	Since Inception (11/30/2022)
Franklin Intermediate High Yield Municipal SMA - Pure GROSS	0.20	0.20	2.85	4.90
Franklin Intermediate High Yield Municipal SMA - NET	-0.18	-0.18	1.33	3.36
Bloomberg Municipal Bond Index	-0.22	-0.22	1.22	3.19

Calendar Year Returns (USD %)

	2024	2023
Franklin Intermediate High Yield Municipal SMA - Pure GROSS	4.00	8.02
Franklin Intermediate High Yield Municipal SMA - NET	2.46	6.43
Bloomberg Municipal Bond Index	1.05	6.40

The strategy returns shown are preliminary composite returns, subject to future revision (downward or upward). Please visit www.franklintempleton.com for the latest performance figures. Past performance is not a guarantee of future results. An investment in this strategy can lose value.

Performance data represents past performance, which does not guarantee future results. Current performance may be lower or higher than the performance data quoted. Investment return and principal value will fluctuate with market conditions, and you may have a gain or loss when you sell your shares. Periods less than one year are not annualized. Performance results are for the composite which includes all actual, fully discretionary accounts with substantially similar investment policies and objectives managed to the composite's investment strategy. Composite returns are stated in U.S. dollars and assume reinvestment of any dividends, interest income, capital gains, or other earnings. The composite may include account(s) that are gross of fees and pure gross of fees. "Pure" gross-of-fee returns do not reflect the deduction of any expenses, including transaction costs. A traditional (or "true") gross-of-fee return reflects performance after the reduction of transaction costs but before the reduction of the investment advisory fee. The gross-of-fee return may include a blend of "true" gross-of-fee returns for non-wrap accounts and "pure" gross-of-fee returns for wrap accounts. Net-of-fee returns is reduced by a model "wrap fee" (1.5% is the maximum anticipated wrap fee for fixed income portfolios) which includes trading expenses as well as investment management, administrative and custodial fees. The model wrap fee used represents the highest anticipated wrap fee applicable to the strategy. Actual fees and account minimums may vary.

Investment Team

Jeff Snyder
Years with Firm 27
Years Experience 27

Dylan G. Sanderson
Years with Firm 21
Years Experience 21

Francisco Rivera
Years with Firm 30
Years Experience 31

Chris Sperry, CFA
Years with Firm 29
Years Experience 29

Lloyd Nemerever, CFA
Years with Firm 3
Years Experience 32

Daniel Workman, CFA
Years with Firm 21
Years Experience 22

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The primary benchmark for this composite is the Bloomberg® Municipal Bond Index. This index is a sector market value capitalization weighted fixed income index comprised of general obligation, revenue, insured and pre-refunded/escrowed municipal bonds selected to be representative of the market. The Bloomberg Municipal Bond Index is an unmanaged index representing the investment environment existing during the time periods shown.

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FRANKLIN TEMPLETON

One Franklin Parkway
San Mateo, CA 94403-1906
(800) DIAL BEN/342-5236
franklintempleton.com